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No. 99-1321

IN THE

Supreme Court of the United States

AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES,
Petitioner,

v.

UNITED STATES OF AMERICA,
Defendant.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONER

Nothing in respondents' opposition weakens the case for this Court's review or supports the decisions below. The government's central argument, that Congress may withdraw a former deduction for lobbying, and subject that income to the ordinary income tax, is not even in dispute. The dispute is whether the special provisions Congress fashioned solely for associations merely withdraw a formerly available deduction or overshoot that goal and impose additional, affirmative burdens on associations or their members if the associations lobby.

The government does not even contend that associations that lobby are subject to a generally applicable income tax. Instead, the government argues that Congress need not apply the same income tax when income is used for lobbying, Op. Cert. 10-11 n.3; that the generally applicable tax rule does not apply when the provision is an elective alternative (but the Court also need not review the only other alternative to determine whether either may be constitutionally imposed), *id.* at 10, 13; that some political support existed for some version of the provision, *id.* at 12; that a tax provision affecting a single constituency bears some resemblance to the challenged provision, *id.* at 12 n.5; and that Congress did not mean to penalize and deter lobbying, *id.* at 10.[1] Finally, the government attempts to defend the tax by comparing the two alternatives imposed by the challenged statute – not to the generally applicable income tax – but to *each other*. *Id.* at 11-12.

None of these contentions bear on the constitutional

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[1]This Court has long since rejected the view that lack of animus is a defense, even if true. *See Minneapolis Star and Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 592 (1983) ("Illicit legislative intent is not the sine qua non of a violation of the First Amendment"); *Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 228 (1987); *Simon & Schuster, Inc. v. Members of New York Crime Victims Bd.*, 502 U.S. 105, 117 (1991). *But see also* Pet. 3 & n.1, 13 & n.11.

question at issue. Under this Court's consistent jurisprudence, taxes reaching First Amendment activities are presumptively constitutional *only if* they are generally applicable taxes. Differential taxes on First Amendment activities are subject to strict scrutiny, a test neither court below applied and even the government does not claim would be met here. *See Leathers v. Medlock*, 499 U.S. 439, 446 (1991) (differential taxation "places such a burden on the interests protected by the First Amendment, that it is presumptively unconstitutional"); *Minneapolis Star and Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 582 (1983); *Regan v. Taxation With Representation*, 461 U.S. 540, 545 (1983) ("*TWR*"); *Cammarano v. United States*, 358 U.S. 498, 513 (1959). On its face, the statute imposes a special set of tax rules if associations lobby, rather than the income tax rules ordinarily applicable to corporations or individuals. Pet App. 30a-34a.

The applicable question, which the Opposition steadfastly avoids, is whether the method of taxation these rules impose is different from the generally applicable income tax, and if so, whether the result is more onerous than if Congress had simply withdrawn any former deductions or exemptions for lobbying, leaving income spent to lobby subject to ordinary income tax. Because both questions must be answered in the affirmative, *see* Pet. 12-21, the decisions below upholding the tax present a square conflict with decisions of this Court.

1. The government's claim that the proxy tax is not penal disregards the constitutional standard promulgated by this Court. Whether a tax scheme imposes a differential tax resulting in affirmative burdens on First Amendment activities, rather than simply not subsidizing those activities, can be understood only by comparing the tax to generally applicable taxes to determine if exercise of protected rights results in a higher tax than engaging in other activities. *See Minneapolis*

Star, 460 U.S. at 581-82, 590 nn. 12 & 13; *TWR*, 461 U.S. at 545. The government challenges none of petitioner's comparisons demonstrating that both alternatives imposed by the lobby tax are more burdensome than ordinary income tax. Instead, the government seeks to substitute a more lenient – but constitutionally irrelevant – test: whether the two alternatives imposed by the challenged scheme impose equal burdens.

Comparing the proxy provision to the flow-through provision, Op. Cert. 11-12, begs the real question because both sets of provisions assume that members can be taxed on lobbying funded from income earned, not by the members, but by the association itself from sales of goods and services.[2] Thus, the government defends the proxy tax's 35% rate on *all* lobbying expenditures by comparing it to the tax members would pay if they were taxed on *all* lobbying expenditures by the association, as under the flow-through rules. Both sides of this comparison assume the constitutionality of taxing members on income they were never entitled to – if their associations lobby – despite the stark contrast between that rule and the generally applicable income tax in which taxpayers are responsible for paying taxes only on income they earn.

The government's position is that it is constitutionally permissible to tax association members on lobbying they did not fund because they presumably *benefit* from the lobbying. Op. Cert. 14. In this, the government is again attempting to substitute a different test than this Court has adopted to avoid the fact that the challenged tax is both different and more

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[2]Associations earn income from conventions, educational programs, facilities rental, etc. Most mature associations rely on such activities for 70% to 80% of their income. Income from activities deemed "related" to the group's purpose is tax-exempt; income from "unrelated" activities is taxed under ordinary corporate income tax provisions. Pet. 4 n.2, 5 n.3, 6.

onerous than the generally applicable tax.[3] A tax on those who "benefit" from someone else's expenditures is clearly *different* from ordinary income tax which is triggered only by receipt or entitlement to income. It is also more onerous, because it shifts tax liability from lower bracket entities (associations) to higher bracket ones (most members), resulting in a higher tax than imposed by the generally applicable income tax.[4]

Further, the government's argument does not establish the proxy tax as one that could legitimately have been levied on members even with respect to the portion of lobbying expenditures they actually fund through dues or contributions. The government itself admits that the proxy tax exacts more tax than could be exacted from some members, Op. Cert. 11, which alone undermines its position. *See* Pet App. 5a.[5] Its attempt to

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[3]The government's emphasis that members receive this "benefit" *in return for dues* does not help its argument. Members receive benefits from every association activity *in return for dues*. Under the "benefit" theory, Congress may tax members for every association expenditure. A member paying $100 in dues would pay tax not only on the $100 of his own income he used to pay dues, but also on, *e.g.*, $300 the association earns from sales of goods and services – income the association may not distribute to its members, 26 U.S.C. § 501(c)(6). Adopting this theory would impose a significant burden on associational rights, apart from speech , underscoring the need to subject protected activities to only generally applicable taxes.

[4]The government's claim that associations requested the proxy tax, Op. Cert. 12, has no bearing on whether the tax is constitutional or penal. First, the support of some constituency cannot empower Congress to enact a law prohibited by the constitution. Second, although some associations asked Congress to provide an association-paid alternative, even the government does not claim that *any* association asked Congress to impose a tax rate far higher than would be imposed under the generally applicable income tax.

[5]The government's claim that the 35% flat proxy tax rate is no higher than *some* members in lower brackets would pay is also inaccurate, because it conflates tax on income spent to lobby with tax on other income.

elude the necessary implications by arguing that Congress may provide a generally applicable tax scheme advantaging small corporations, but withhold that advantage if the corporation is an association that lobbies, Op. Cert. 11 n.3, wholly disregards this Court's decision in *Speiser v. Randall*, 357 U.S. 513 (1958), and many reaffirmations that "the government may not deny a benefit to a person because he exercises a constitutional right." *TWR*, 461 U.S. at 545.

Contrary to the Opposition, this rule does not require Congress to leave a loophole; but it does limit Congress's choices for closing loopholes. Congress can impose generally applicable taxes on any income members provide associations to lobby just as it taxes income members spend to lobby directly. Congress can also require associations to pay ordinary corporate tax on their independent income used to lobby. Such an approach both satisfies the constitution and taxes every dollar associations spend to lobby – leaving no loopholes.[6]

Members taxed at 15% or 25% pay less tax than associations, if they lobby directly; members taxed at 35% pay the same – both are taxed 35% of the amount spent. Because members' net income is taxable, the income used to pay the lobby tax is itself subject to income tax. The government's "gross-up" argument misleadingly counts the cost of paying that tax as a cost of lobbying, which it is not. It is the cost of earning the income used to pay the tax, and is due whether it is used to pay income tax, distributed it as a dividend, invested in stock, or contributed it to an election campaign.

[6]The government's putative "loophole" – that members would obtain lobbying at a lower tax cost than if they lobbied directly, Op. Cert. 14 – is simply another way to say members benefit from the lobbying funded by the association through its independent income. A tax based on *that* principle is not only unlike generally applicable taxes, *supra*, it is unlike other lobby tax provisions. For example, shareholders, who as owners directly benefit from corporation lobbying, are not taxed on the income the corporation spends to lobby. Corporations pay tax on that income at their ordinary rate.

2. The government's defenses of the other flow-through provisions – the estimation penalties – are also inapposite. The government does not even suggest that the estimation rules are necessary, or even useful, to serve any government interest. The government's intimation that no overestimation forfeitures occur *because the Secretary has not administered the statute to impose forfeitures*, Op. Cert. 16, mischaracterizes how the statute operates. Under the flow-through rules, associations must provide members in advance with a percentage of dues that are non-deductible, based on estimates of future lobbying expenditures and dues receipts. Members are required to pay tax on that percentage of dues – even if the association then lobbies less than predicted. Although, as the government notes, Congress suggested that the Secretary prescribe regulations to avoid this result, Congress did not *require* the Secretary to do so, and for the seven years since enactment, the Secretary has chosen not to propose or adopt such regulations.

The government's defense of the underestimation penalty as a *substitute* for taxing members is simply a restatement of its proxy tax arguments, Op. Cert. 15, and suffers from the same flaws of relying on an irrelevant comparison instead of the applicable constitutional test, and disregarding the onerous consequences of the special tax. The government concedes that the Secretary has unfettered discretion over whether to waive this penalty but fails to distinguish the delegation of discretion here from those this Court has found invalid previously. The government's suggestion that this uncertainty lacks consequences defies common sense. In making lobbying choices, an association would very likely find significant the difference between having to pay a 35% tax out of current budget and having its members taxed at various rates in a future year. The government's additional argument that after-the-fact judicial review of the Secretary's decisions is available, Op. Cert. 15-16, misunderstands the relevant precedent. This Court

has consistently found such review insufficient to protect First Amendment rights, repeatedly invalidating laws delegating unguided discretion *despite* the availability, in each case, of after-the-fact judicial review. *See* Pet. 20-21 (citing cases).

3. The government's attempt, in the alternative, to insulate this tax scheme from review altogether because the statute provides a choice between two sets of rules is inconsistent with fundamental principles of due process as well as this court's analyses of similarly constructed laws. *See* Op. Cert. 10 (proxy tax, as elective alternative, not subject to First Amendment review); 13 (flow-through rules not before court). A statute imposing alternatives is reviewed to determine if *any* of the alternatives permitted may be imposed. *See, e.g., Planned Parenthood v. Casey*, 505 U.S. 833 (1992); *Hodgson v. Minnesota*, 497 U.S. 417 (1990). The government does not dispute that petitioner is subject to the entire association lobby tax scheme; that the scheme requires it to choose between two alternatives; and that, under either, it is subject to obligations and potential penalties. If, as the government suggests, the proxy tax were truly *elective*, petitioner would have chosen not to pay it. Its choice, however, was to pay the proxy tax, comply with the flow-through provisions, or suffer civil and criminal penalties. Because the proxy alternative does not meet the constitutional standard – it imposes a differently structured and more onerous tax on associations than would ordinary income tax – review of the *other* alternative is necessary to determine if the tax scheme as a whole is a valid imposition. That alternative also fails the standard, imposing a differently structured and more onerous tax on association members.[7]

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[7]The government's focus on whether ASAE's lobbying expenditures can be traced to specific income sources is beside the point. Tracing is disregarded under either statutory alternative. The question, under *FCC v. League of Women Voters*, 468 U.S. 364, 400 (1984), *Rust v. Sullivan*, 500

4. A *TWR*-type dual structure cannot be relied upon here to insulate associations and members from these differential tax burdens because, under the Treasury's Anti-Avoidance Regulation, the IRS remains free to disregard that structure and tax associations as if they had not separated into a lobbying and non-lobbying organization. *See Treas. Reg.* § 1.162-29(f) (set forth at Pet. 24). The government claims otherwise by interpreting the vague terms of the provision to protect a dual structure from being recast if the lobbying organization's purpose is to promote common business interests of its members and if it is not funneled funds from the non-lobbying organization in non-arm's length transactions. Op. Cert. 6, 8.

But the government's "plain meaning" interpretation of the regulation would be more reassuring if it had not taken precisely the opposite position in the court below. In that forum, government counsel stated that a dual structure *would be* recast if the lobbying organization was funded by anything other than dues and contributions. The government's *new* interpretation is not adopted in a rulemaking or adjudication,

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U.S. 173, 179 (1991), and *TWR*, 461 U.S. at 545, is whether the challenged law *permits* associations to segregate the income spent to lobby, so as to confine the tax to withdrawing only former lobbying subsidies. It is undisputed that neither statutory alternative permits such segregation, that associations earn income independent of member contributions, and that neither alternative makes any attempt to distinguish between member contributions and independent income earned by associations but arbitrarily treats all lobbying as funded by member contributions. The government's suggestion that ASAE necessarily paid for lobbying from dues, Op. Cert. 14, is simply wrong. Had it checked ASAE's final tax status with its own Treasury Department, it would know ASAE had substantial net income from unrelated business activities. In addition, as the government knows, ASAE had substantial net income from *related* business activities, its largest source of income. The government's additional assumption that *all* dues income is net income available to spend on lobbying fails to take into account the significant costs of attracting and retaining the members who pay dues.

and its now *old* interpretation makes clear that the regulation's text alone does not provide reliable or even foreseeable limits on the IRS's use of the regulation to recast dual structures.

As this Court has explained, under the First Amendment "[s]peakers . . . cannot be made to wait for 'years' before being able to speak with a measure of security." *Riley v. National Federation of the Blind*, 487 U.S. 781, 793-94 (1988). Associations are in the same position as the fundraisers in *Riley*. They may adopt a dual structure, keep transactions at arm's length, support lobbying by various means including income from related business activities undertaken by the lobbying organization. It may be years, however, before the organization knows the tax consequences. In the interim, associations will be faced with the knowledge that if they adopt such a dual structure, it may be disregarded by the IRS, with resulting higher taxes. They can mitigate these consequences only by not lobbying, limiting the sources of funds spent to lobby, or lobbying less.

Like the "reasonableness" requirement struck down in *Riley*, the Treasury regulation's vague reasonableness requirement "necessarily chill[s] speech in direct contravention of the First Amendment's dictates." *Id.* at 794. Associations are subject to a tax scheme in which affirmative penalties, or a Damoclean threat of penalties, are the consequence of exercising First Amendment rights of speech, petition, and association. The Treasury's regulation also differentiates the tax scheme at issue here from the one upheld in *TWR*. As petitioner explained, Pet. 22-24 – and the government does not deny – no such "anti-avoidance" regulation looms over dual structures formed by charitable organizations. This Court's determination that the challenged provisions were valid in *TWR* was *premised* on its finding that a dual structure would permit a charity to ensure that it was subject to only generally

applicable tax rules because the applicable Treasury rules only required the two groups to be separately incorporated and to keep records showing that tax-deductible contributions were not funneled to the lobbying group. 461 U.S. at 544 n.6.

The decision below does not follow directly from this Court's decision in *TWR* because associations are not provided the same protection as charities if they adopt a dual structure. This case presents the question not addressed in *TWR* – the import of more burdensome IRS requirements. Further, this case raises issues similar to those presented by *Legal Services Corp. v. Velazquez*, No. 99-603, and *United States v. Velazquez*, No. 99-960, which this Court has accepted for review, concerning the requirements with respect to dual, or other multiple, structure solutions to safeguard First Amendment rights from otherwise invalid government-imposed burdens.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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